

**STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS
PUBLIC UTILITIES COMMISSION**

IN RE: PAWTUCKET WATER SUPPLY BOARD

DOCKET NO: 3674

**MEMORANDUM IN SUPPORT OF THE PAWTUCKET WATER SUPPLY BOARD'S
PROPOSED CHANGES IN RATES**

I. INTRODUCTION

On April 11, 2005, pursuant to Rhode Island General Law §39-3-11 and Part II of the Public Utilities Commission's ("Commission") Rules of Practice and Procedure, the Pawtucket Water Supply Board ("PWSB") gave notice of filing an application to increase rates. The PWSB's proposed rates were designed to collect additional operating revenue of \$3,540,101.00 to support total operating revenue requirements of \$19,972,083. The impact of this request would have resulted in a 22% increase in revenues. The PWSB also proposed an alternate rate design providing for a surcharge to Cumberland ratepayers, which if approved, would have established an alternate rate design with non-Cumberland ratepayers receiving an increase of 16.7% and Cumberland ratepayers receiving an increase of approximately 37.3%.

As required, The Division of Public Utilities and Carriers ("Division") reviewed the PWSB's proposed rate change. After reviewing the PWSB's rate filing, the Division recommended an increase of \$1,342,795 or 8.03%. During the litigation of this Docket, the respective positions of the PWSB and the Division were revised. Currently, the PWSB is requesting an increase of \$3,138,001, or 19.3%, and the Division recommends an increase of \$1,376,078, or 8.25%, which is only slightly more than their original position. It should be noted that the Division did not object to the cost of service study submitted by the PWSB.

In this Docket, the Town of Cumberland and the City of Central Falls filed Motions To Intervene. While the Town of Cumberland submitted testimony from witnesses in support of Cumberland's objection to the proposed rate differential for Cumberland customers, the City of Central Falls did not submit any witnesses. On September 16, 2005, at the hearing in this matter, the Pawtucket Water Supply Board withdrew its request for an alternative rate that would have provided a surcharge on the PWSB's customers in Cumberland. By agreement of the parties, the PWSB's request for an alternative rate was withdrawn without prejudice to the PWSB requesting a surcharge on Cumberland's customers in future rate filings.

As such, the main issue to be decided by the Commission is the appropriate revenue requirement for the PWSB.

II. ARGUMENT

A. REVENUE REQUIREMENT

At the outset, the PWSB recognizes that a fully contested Docket in a rate case of this nature is more the exception than the rule. However, it is the PWSB's belief that the issues to be decided by the Commission are of vital importance in this Docket, and in future Dockets as well.

The PWSB recognizes that *any* requested rate increase is significant. However, a requested rate increase must be judged on its merits and the needs of the utility. No increase should be judged solely by its perceived size. A "small" increase should not be granted simply because it is "insignificant," and a "large" increase should not be denied because it is deemed "significant." A requested rate increased should be judged on the individual facts in each Docket. Based on the facts developed in this Docket, the PWSB believes its proposed rate increase is both warranted and justified.

The disagreements between the parties in this Docket over an appropriate revenue requirement are mainly between the PWSB and the Division. Currently, there are five areas of disagreement between the PWSB and the Division regarding revenue requirement. Neither Cumberland, nor Central Falls, offered substantial evidence or expert testimony in opposition to the PWSB's revenue request.¹ As such, the PWSB's and Division's differences are addressed herein below:

1. Projected Consumption

The first, and perhaps most, critical decision the Commission must make in this Docket is a determination of the PWSB's rate year water sales. The Division has requested that the PWSB's pro forma metered sales revenue be determined by utilizing a three year or five year average of total consumption. In Pamela Marchand's and Christopher Woodcock's testimony, the PWSB has provided actual, empirical and factual data to demonstrate that since Docket 2674 in 1998, projected rate year water sales based on averaging have consistently overstated actual sales. This in turn, has led to the PWSB's failure to collect revenue that the Commission – through its decisions or through approved settlements – has deemed necessary. Thus, projections based on historic averages have not been a good determinant for future sales.

In an effort to prevent this from happening yet again, and in recognition of the downward trend in sales, the PWSB has proposed utilizing its test year consumption as its rate year consumption. While the PWSB recognizes that the use of test year consumption rather than averaging is a deviation from past practice, it is not an inappropriate methodology. In fact, this Commission itself indicated that it may be wholly appropriate. As stated in a recent Kent County Water Authority rate case order, "If a Water Utility could demonstrate a clear downward trend in

¹ Cumberland's objections in this area were limited mainly to the effect they would have on the surcharge. Central

water sales, the Commission might depart from the typical multi-year average approach in order to better estimate future water sales.” (See Docket 3660, Order #18316.) The PWSB has made such a showing in this Docket. In fact, the PWSB has proven that there is a demonstrable downward trend in consumption, and the projected consumption based on averaging has been higher than actual consumption. (C. Woodcock Schedule 2.1) Therefore, it is the PWSB’s position that averaging consumptions has not provided an accurate forecast in past Dockets, and should not be used in determining an appropriate rate increase in this Docket. Thus, the question to be resolved is whether the PWSB’s rates will be based on actual, empirical and factual data showing declining water sales, or whether they will be based on averaging merely to continue past practice.

The Division’s expert, Andrea Crane argues that rate year sales should be normalized to derive “a 12 month period of normal operating results and conditions.” (Tr. v.II, p 163)² Thus, Ms. Crane claims to use averaging to “normalize” sales in the rate year. (Crane Direct, p. 15, Crane Surrebuttal, p. 4) Yet, under cross examination, Ms. Crane agrees that averaging is not the same thing as normalizing. (Tr. v.II, p. 161). Further, while Ms. Crane testified in direct and surrebuttal testimony that an actual test year is not *necessarily* representative of future operating conditions, she does concede that a test year *can* represent future operating conditions. (Crane Direct, p. 10, Crane Surrebuttal, p. 4, Tr. v.II, p. 162).).

So the question is – if projected usage has been consistently overstated resulting in insufficient revenues – why not use the test year usage in the rate year? The Division’ opposition appears to be twofold: (a) past practice dictates that averaging be used, and (b) the use of a test

Falls submitted no testimony.

² All cites to Tr. v.II are to the transcript for the hearing date September 14, 2005.

year does not account for fluctuations caused by factors that affect sales such as rainfall, temperature, demographics and changes in plumbing fixtures, (Crane Direct, p. 7, Crane Surrebuttal, p. 5, Tr. v.II, p. 168) However, on the second point, Ms. Crane acknowledged that she had no information on how many of these factors applied to the PWSB. On the other hand, Mr. Woodcock's rebuttal testimony demonstrates that Ms. Crane's two most significant factors have had no correlation to water sales for PWSB in recent years.

As set forth in Ms. Crane's direct testimony, it was her position that "The most significant factors that influence the variations in annual water consumption from year-to-year are rainfall and temperature." However, as first acknowledged by Ms. Crane in the Division's answers to data requests, she did not even consider temperature data in arriving at her conclusion. (Division response to PWSB Data Request 2-3) This was confirmed by Ms. Crane on cross examination. (Tr. v.II, p.174, 177). Thus, Ms. Crane did not utilize data to support what she claims is one of the two most significant underpinnings of her opinion on water usage.

Similarly, Ms. Crane had no specific information on the other factors she cited:

Q.You indicate on Page 5 of your surrebuttal, you talk about the use of a relatively short average period reflects the impact of other factors in an attempt to influence water sales over time. You talk about plumbing fixtures, demographics factors, economic factors. How do those factors apply specifically to the Pawtucket Water Supply Board?

A. Well, I haven't done a study to determine the specifics with regard to the Pawtucket Water Supply Board. I assume that there are -- that they meet general demographics. For example, with regard to fixtures, I assume that to the extent there is new construction or replacement of fixtures, that those fixtures are more efficient. I would think, however, that given my understanding is that your service territory, for example, doesn't have a lot of new large homes going up, so therefore, the turnover in fixtures would probably be much slower in something like Pawtucket than it could be if they were building new homes on big lots and they're putting in four bathrooms.

THE WITNESS: . . . So I mean, I haven't done a study specific to Pawtucket, but my feeling would be that you would have a slower -- you'd be slower with regard to replacement of fixtures. You know, with regard to demographics, I mean, I'm not sure, not having done a study about your specific area, with regard to demographics. I'm not sure. I don't get the impression that there are a lot of, you know, new large homes with, you know, a lot of -- with high water consumption.
(Tr. v.II, p. 168-169)

Q. You said you don't necessarily think that that's the case, but you don't have any data to rely upon to make that statement, do you?

A. I don't have any specific data about the demographics. I have heard, however, that Pawtucket is an older community, generally a community with not a lot of active turnover, although perhaps that's changing based on the testimony of Ms. Marchand with regard to the types of housing that's there, so there wouldn't be any reason to expect that there would be a dramatic demographic shift, for example, that would result in a significant drop in water consumption. So I mean, something must be going on.
(Tr. v.II, p. 179)

In direct contradiction to Ms. Crane's speculation on factors that affect water usage, the PWSB actually examined applicable data to analyze the past history of actual sales versus projected sales as well as the effect of "the two most significant factors" – rainfall and temperature – on sales. This information can be found in:

- Pamela Marchand's schedule PMM1 – this schedule demonstrates that in every one of the past four dockets that Pawtucket's actual collections were substantially less than allowed revenues by amounts that were far in excess of the operating revenue allowance.
- Christopher Woodcock's Schedule 2.1 and Rebuttal Schedule 2.1 – these schedules presented the absolute difference between actual sales the past five years and the five year average. Rebuttal schedule 2.1, also added the data for FY 2005 and calculated a six year average. From this schedule it is clear that for the (most recent) past four years the six year average overstated the actual sales in every case. In addition, this schedule clearly shows a continued drop in sales, despite an increase in customers.

- Christopher Woodcock Rebuttal Testimony P.9 – by using the NOAA data for June – August of the eight summers from 1996–2003, Mr. Woodcock ranked each summer for rainfall, and compared these to Pawtucket’s retail water sales assigning a ranking to the highest sales year (presumably corresponding to the hottest temperatures and least rainfall) and the lowest sales year (presumably corresponding to the coolest temperatures and most rain). To summarize his position, Mr. Woodcock charted his findings on graph. If Ms. Crane’s theory is correct that rainfall and temperature are “the most significant factors that influence annual water use” one would expect the indices to show some degree of matching. However, the graph showed that there was very little correlation. The hottest and driest year (1999) was only the third highest sales year. The highest sales year (1996) was almost the coolest summer and had rather average rainfall. The lowest sales year (2003) was indeed one of the wettest and but had just average temperatures.

Ms. Crane did not disagree with the data used by Ms. Marchand and Mr. Woodcock, nor did she offer any evidence or testimony on this matter. (Crane Surrebuttal, Tr. v.II, p. 176) Under cross examination, it was clear that Ms. Crane didn’t incorporate temperature data in her findings; didn’t have any specific data about the PWSB’s demographics; and didn’t have any specific data on changes in plumbing fixtures. In fact, Ms. Crane who originally stated in her direct and surrebuttal testimony that rainfall and temperature were the two most significant factors, modified her position at the hearing when she testified: “I did not include temperature data in my testimony. I felt the rainfall data was much more useful and very enlightening.” (Tr. v.II, p.174, 177). Thus, logic would dictate that in Ms. Crane’s opinion, the most significant factor affecting water consumption is rainfall. Yet, the PWSB’s testimony shows that rainfall had little if any correlation to water sales. (Woodcock rebuttal, page 9) When asked why rainfall was now the most important factor, Ms. Crane testified as follows:

THE CHAIRMAN: Ms. Crane, let me ask you something. Educate me. Is the reason -- what are the reasons why you consider rainfall to be much more important than temperature?

THE WITNESS: Because most people are worried about their lawns, frankly, and what temperature will do with regard to irrigation, what temperature will do is it will basically allow you to perhaps delay watering your lawn but it won't eliminate the need. Basically, the rainfall is what's going to be the largest driver in whether or not you're going to water your lawn. So if you have a dry summer but a cool summer, you're still probably going to have to water your lawn a fair amount because it's just not getting the watering needs. (Tr. 180)

Ms. Crane's testimony on this subject completely ignores conservation measures. The fact is (as indicated by Commissioner Holbrook himself) some people ignore the needs of their lawn in an effort to conserve water (Tr. v.II, p.88)

Ms. Crane acknowledges that actual sales have been consistently overestimated resulting in the PWSB collecting less revenue than approved by this Commission. In fact, one need to go back no further than Docket #3497 in which the PWSB was authorized to collect \$13,933,789, and they actually collected \$12,208,140, 12.4% less than allotted. (See Schedule PMM1) In response thereto, Ms. Crane merely states that it was not her "intent...to have "high" estimates." It is the PWSB's position that intentional or not, the Division's "high" estimates have had a detrimental effect, and threaten to do so again.

As Ms. Marchand testified, the under collection of funds has

"prevented us from fully funding operations and maintenance. Certain maintenance and equipment purchases are routinely put off until the end of the fiscal year, as past experience has taught us that there will not be sufficient income to fully fund the budget. As a result, projects such as watershed brush control, building maintenance, tank painting, fencing, purchase of leak detection equipment, computerized billing program modifications, etc., are reduced or put off year to year." (Marchand Direct, p. 7-8)

As Ms. Marchand further testified,

“This issue is critical to the continued funding of PWSB operations and maintenance programs. The PWSB has under funded this budget in the past due to the under collection of revenues to the point of requiring a major replacement/ renovation of the entire water system. Maintenance programs have been cut or put off, employee positions left vacant.” (Marchand Rebuttal, p. 15-16)

If not corrected, the under collection of revenue will cause even greater problems given the restrictions placed on the PWSB by its bond indenture. As discussed by Ms. Marchand in her pre-filed testimony,

“the bond indentures require that the O&M budget, Debt Service fund and O&M Reserve fund be fully funded – regardless of revenues. Should this have insufficient funding for these accounts, the IFR account would not be fully funded. In this scenario, it is very plausible that the IFR account could be significantly under funded. The PWSB is dependent on this account for annual capital replacement programs, including the main replacement program. The main replacement program is bid the year before construction, in the amount of \$2 million to \$3 million. To insure sufficient funding, the PWSB may need to delay the main replacement program once again, depending on the levels of IFR funds available.” (Marchand Rebuttal, p.16)

The Division takes the apparent position that these issues should be ignored because they have not impacted the PWSB’s ability “to provide safe and reliable service... in spite of the fact that revenues have not been as high as were projected.” (Tr. v.II, p. 158) According to Ms. Crane, “there are things the Pawtucket Water Supply Board would like to be able to do that they can’t, just like there are things that I would like to be able to do and I can’t...” Thus, the Division appears to be arguing in favor of a new standard in rate cases – providing just enough revenue to merely provide “safe and adequate” service. (Tr., v.II, p.186) This austerity platform should be rejected.

A utility such as the PWSB must do more than avert daily disasters. While a utility must provide safe and reliable service in the here and now, it must also take steps to ensure that it will

be able to do so in the future. A utility must pursue a course of preventative maintenance in its system. The consistent delay of routine maintenance is pennywise and pound foolish. In the long run, a consistent course of forced delay due to insufficient funds is more costly to the ratepayer.

There is also a much more fundamental issue here – the PWSB is not collecting the revenues that this Commission has deemed appropriate and necessary to operate the utility.

Commissioner Holbrook himself accurately summarized this problem:

COMMISSIONER HOLBROOK: I can certainly be wrong, but my understanding and my expectation is that we review the information that outlines the expenditures and whatnot, we satisfy ourselves that they're needed, that they're necessary, that they're essential to the operation of the business and we set a rate accordingly to generate the revenue so there's a match, and in a perfect world, which there isn't, there never will be, they would both match up and everybody's happy, but when the imbalance occurs and the revenue is not collected, then my concern is that essential things that were reviewed and approved in setting the rate won't get done, the essential things being, you know, capital programs and debt service and everything else that they're supposed to do to maintain the infrastructure and the operation of the company. And over a period of time if there's a shortfall, then my concern is how they live with it. And they can defer and they can put off only so long and I guess the answer would be then that they come in for another rate review and try to make up for it. (Tr. v.II, p.208)

Although Ms. Crane seemed reluctant 4, she did eventually concede that the Commission sets rates based on a utility's costs and expenses. (Tr., v.II, p.224). She also conceded that “the Commission has set rates based on revenue projections that in many cases have not been realized, in fact, have not been realized since 1999.” (Tr., v.II, p.190) Thus, in this Commission's recent decisions in contested hearings or approving a settlement reached between the parties, the Commission has approved expenses and set appropriate revenues designed to meet those expenses. In settled cases, the Division itself approves the necessary expenses and revenues. However, the PWSB's recent history has shown that it has not collected the revenue allowed to

meet approved expenses in both contested and settled cases.

If the Division's estimated water consumption is unintentionally high again, the PWSB, and ultimately its customers, will suffer. On the other hand, if the PWSB's forecast is low, there will be very little negative effect. As Mr. Woodcock testified, if the PWSB's revenues are more than allowed due to higher consumption:

"In that case Pawtucket will indeed generate revenues that are in excess of those allowed. Unlike an investor owned utility with stockholders, no one gets a dividend for profits at Pawtucket. No one gets a higher return on their investment. Perhaps the added revenues would allow Pawtucket to delay its next rate filing somewhat, thereby reducing its regulatory expenses in the long run, saving the rate payers a little money. Frankly I do not see a down side in the unlikely event that revenues slightly exceed expectations. On the other hand, while another revenue deficit may result in slightly lower rates in the short run, they will be more than offset by increased regulatory costs necessitated by more frequent filings before the PUC." (Woodcock Direct, p. 15)

In short, the PWSB completely disagrees with Ms. Crane's position that it has not provided a "compelling" reason to deviate from the Commission's past practice of normalizing rate year sales by averaging historical sales. In fact, the evidence in this docket provides compelling reasons to reject the Division's position – it's been proved to be inaccurate. The PWSB has demonstrated a clear downward trend in water sales through facts and statistics. In response to PWSB's demonstration that the 5 year average is not a good predictor of future sales and does not produce "normal" sales, the Division's only response is to assert that their method is standard practice. The Division has not refuted PWSB's demonstration and has offered no testimony to suggest that their "averaging" method is a better predictor of future results. Simply relying on past practice does not make the result correct. In fact, the PWSB has clearly shown

4 See Tr., v.II, p.205

that the Division's method derives incorrect results.

2. Customer Growth Adjustment

In her direct testimony, Ms. Crane recommended a revenue adjustment to reflect 144 additional residential customers. (Crane Direct, p. 13). In his rebuttal testimony, David Bebyn argued against this adjustment as Ms. Crane had not acknowledged the steady decline of industrial sales. (Bebyn Rebuttal, p. 2). As Mr. Bebyn pointed out, the decline in industrial sales far exceed any fluctuations in residential or small commercial. Yet, Ms. Crane refused to build in any factor for industrial losses.

Ms. Crane simply ignored Mr. Bebyn's testimony on this subject in her surrebuttal. (Tr., v.II, p.193) It was Ms. Crane's belief that a loss in one class of customer should not offset a gain in another. Rather, it was Ms. Crane's position that the loss in industrial sales should have been accounted for as a pro forma adjustment. This position clings to form over practical function. Clearly, Mr. Bebyn has shown a decrease in overall customer growth due to declining industrial sales. This uncontested information should be given weight. It should not be ignored because the Division believes it should have been presented in a different manner.

In addition, Ms. Crane ignored Mr. Woodcock's rebuttal testimony regarding the correlation between customer growth and sales. As set forth by Mr. Woodcock:

- From 1997 to 2000 there was an increase of 176 customers. Sales didn't grow – they dropped by 12%.
- From 2000 to 2002 there was an increase of 146 customers (nearly the same as projected by Ms. Crane). Sales did not increase by any where near the 21,327 ccf projected by the Division – in fact, they dropped 7%.
- From 2002 to 2004 there was an increase of 184 customers. Again, sales did not increase – they also dropped by another 3%.

(Woodcock rebuttal, p. 11-12)

These actual numbers directly contradict Ms. Crane's position, and clearly demonstrate that despite growth in the number of the PWSB's customers – sales went down, not up. The PWSB has provided concrete data and information clearly demonstrating that the Division's position on increased sales due to customer growth is totally incorrect. Rather than address this testimony, the Division has ignored it. Do they agree or disagree? In any case, the PWSB's rebuttal testimony and data on this matter is unrefuted. The only clear evidence before the Commission shows that (a) there should be no increase in sales for some presumed growth and (b) even if there is such growth, it will result in a decrease in sales. As such, the Division's requested adjustment should be rejected.

3. Employee Positions

Perhaps the one thing all parties can agree to is that the history of employee positions and vacancies in recent PWSB rate filings is confusing. As such, the PWSB won't repeat the history of this issue, but rather refers to its pre-filed testimony on this subject. (Marchand Rebuttal, p. 1-12) What is important, is to analyze the Division's opposition to the PWSB's request in this area.

Ms. Marchand has provided ample testimony on her efforts to revamp the overall structure of the PWSB's personnel as well as the "vetting" process that occurs with the Pawtucket Water Supply Board and the Pawtucket City Council before any personnel decisions are made. Thus, Ms. Marchand's personnel decisions are based strictly on her ability to properly operate the system. Furthermore, the PWSB has shown that the Division's overly optimistic sales forecasts have resulted in reduced revenues, which precluded the PWSB from hiring the full complement of employees it has been authorized.

The Division on the other hand seems to focus on the “number” of employees in effort to lower costs, without considering the effect it has on operations and maintenance.

As Ms. Crane testified:

“I have never said that any of the positions were not necessary. I said that vacant positions should not be funded because we've consistently seen that the actual number of employees has been below the funded level of employees.”

(Tr. v.II, p.195)

“My testimony was that the Board's revenue requirement should be reduced to eliminate the salaries and wages associated with three vacant positions. I was not particularly, you know, drawing any conclusions about the need for those particular employees.”

(Tr. v.II, p.195-196)

“I didn't eliminate those three positions, I eliminated three -- I hate to use the word, but generic positions. To the extent that there are still vacancies, I don't think ratepayers should have to pay for those.”

(Tr., v.II, p. 197)

Q.Well, which generic positions are you recommending be eliminated?

A.My recommendation wasn't based specifically on positions. I think if you go back to my testimony, you'll see that I am not criticizing or opposing the need for any specific positions. My concern is that the Board has consistently had fewer employees than have actually been funded.

(Tr., v.II, p.197)

Q. But the practical effect of eliminating three, as you term them, generic positions is that three jobs will be eliminated, correct?

A. The funding for three positions will be eliminated.

Q. And so with the funding gone, the positions are gone.

A. Some hard choices will have to be made, that's correct.

(Tr., v.II, p.197-198)

Unfortunately, for the PWSB, it does not have any “generic” positions. It only has real positions that are necessary for the proper operation of its system. Ms. Crane asks the PWSB to make “hard choices,” yet she has not performed any analysis of whether these hard choices are in the best interest of the utility.

Not only would the Division have needed positions left vacant, they also seek to deny the PWSB's request for temporary employee funding to fill vacancies that may occur. As Ms. Marchand set forth in her testimony, historically the PWSB did not have a separate account to pay for temporary labor. The money for temporary help came from the labor fund for each particular department. Therefore, in Docket 3497, the PWSB did not request rates to cover the cost of the temporary labor help. It simply asked that the general labor fund not be cut, and that 66 positions be funded. Unfortunately, the 66 positions were not funded, and thus money available for temporary help was cut. Thus, the PWSB has requested rates for these costs in this Docket.

In her direct testimony, Ms. Crane stated that "there is no rationale for the PWSB's claim for significant additional temporary employees in her rebuttal testimony." (Crane Direct, p. 22) In response thereto, Ms. Marchand provided a rationale and a concrete examples of why funding was necessary for temporary employees. In particular, Ms. Marchand testified that since the rate filing was submitted, the PWSB had five persons go out on long term absence requiring temporary help. After being provided with this rationale for temporary employee expense, Ms. Crane acknowledged that "having five employees out on long term absence could increase the PWSB's need for temporary labor." (Crane Surrebuttal, p. 10) However, once again, this concrete factual information did not sway the Division's expert, as Ms. Crane further testified that; "these employees were not absent when the PWSB filed its case. Nor is it likely that the PWSB anticipated that these five employees would be out on long-term absence when it filed its case." (Crane Surrebuttal, p. 10).

The Division asked for a rationale of why funding for temporary help is needed, and once

provided, they objected on the basis that these absences could not have been anticipated when the PWSB's rate application was filed. The Division would somehow penalize the PWSB for not knowing the number of absences that would occur when it filed this case, which misses the point entirely. Employee absences can *never* be anticipated. Yet, they happen, and when they do, temporary help is needed. If there is no funding, then the help cannot be hired. Undoubtedly, this will lead the Division to argue in the next case that temporary help is not needed at all.

As Ms. Marchand testified, the PWSB's history of vacancies is directly related to its under collection of revenue (and potentially, in the case of temporary help, the lack of adequate funding altogether). The PWSB's history of operating with 62 employees is due to the fact that there were not sufficient funds collected to fill all of the positions. As set forth in Ms.

Marchand's rebuttal testimony:

"...the PWSB's history of operating with 62 employees was due to the fact that there were not sufficient funds collected to fill all of the positions. It was our belief that this was addressed and rectified in Docket 3378. At that time, the PWSB had 66 positions with several vacancies that were in the process of being filled. The settlement agreement states that: "The Board has represented to the Division that past vacancies were not filled because of inadequate funding, and assured the Division that future vacancies will be minimal due to the extensive need occasioned by the proposed capital improvement projects." Yet in Docket 3497, personnel expense was cut again..." (Marchand Rebuttal, p. 8)

"This personnel issue is also tied to our historic under-collection of revenue. When the PWSB doesn't collect revenue, we are forced to cut back on programs and expenses. This includes filling authorized positions. Then when we come back for a rate increase because of a revenue shortage, the Division uses our lower historic costs and personnel vacancies as evidence that we don't need funding for them after all. Thus, our "vacancies" become a self fulfilling prophecy." (Marchand Rebuttal, p. 9)

The Commission must put an end to this pattern. As stated above, the Division's expert now employs the logic that even though approved revenues are not collected – resulting in necessary projects being deferred and positions not being filled – the PWSB has provided safe and

adequate service, and thus the revenues, projects and positions were apparently not necessary. If this pattern is not stopped, then expenses and positions will continue to be cut until the PWSB cannot provide safe and adequate service. Obviously, this inevitable course of events is not in the best interest of the rate payer.

4. WTP Reserve

In Docket 3497, the Commission approved the establishment of a Water Treatment Plant Reserve (WTP) for repairs on the existing water treatment plant and pump stations. The Commission ordered that the \$778,000 in funds needed for this account be collected in one year. However, the under collection of revenues impacted the WTP reserve as well. As Ms. Marchand testified in her direct testimony:

“Under Docket #3497 a restricted account was established for pumping and water treatment repairs (WTP) to be funded by the PWSB until the new water treatment plant was constructed. However, the PWSB’s bond indentures set forth a specific order in which accounts are to be funded by collections. The first account to be funded is the O&M budget account, then the Debt Service and O&M Reserve accounts. These accounts must be fully funded in the total amounts allocated. The remaining restricted accounts are funded as a percentage of the revenues collected. These accounts are funded in decreasing order as follows: IFR, Central Falls, WTP Reserve. Therefore, as the last account to be funded, the WTP Reserve account was under-funded in FY04 and FY05, as collections have not allowed for full funding of accounts.” (Marchand Direct, p. 8)

Obviously, the funds in this restricted account will no longer be necessary once the new plant is in full operation and the old plant and pump station has been demolished, which is scheduled to occur by the end of 2006. Since the funds will need to be available for the entire calendar year, but not at the full amount, the PWSB is requesting a fifty percent reduction in the rates collected for this account. It was the PWSB’s position that this amount, including the existing amount in the restricted account, should be sufficient to cover any required repairs and

provide a contribution toward the demolition of the water treatment plant and the Spring St. pump station.

The PWSB submitted testimony that there are not sufficient funds to cover costs that should be paid from this account. However, Ms. Crane objected: “It should be noted that the \$1.2 million discussed by Ms. Marchand is based on a bid received on August 22, 2005, the day before her Rebuttal Testimony was filed in this case. Therefore, the WTP Reserve claim contained in the PWSB’s Direct Testimony could not have been based on that estimate. This is clearly another example of PWSB attempting to justify its direct case subsequent to the filing of that case, based on objections raised by the Division in my Direct Testimony.” (Crane Surebuttal, p. 12)

On the contrary, as Ms. Crane clearly knows information that is not available when a rate application is filed, often becomes available during the course of litigation. Simply because information becomes available later rather than sooner does not mean a properly support request should be denied. PWSB had stated that it expected to use these funds for demolition. It was only after Ms. Crane asked for specific information on these costs that PWSB provided the information sought. Now, Ms. Crane would have the Commission penalize the PWSB because they did what she asked for, they obtained concrete data on these costs.

5. Operating Revenue Allowance

The PWSB recognizes that in recent dockets the Commission has provided an operating revenue allowance of 1.5% of operating expenses. However, in this Docket, the PWSB is requesting an operating revenue allowance of 5% of total expenses. It is the PWSB’s position that a reserve of this amount is necessary, that the PWSB has demonstrated the need for this

amount, and that there is no basis or showing for the Division's position other than a precedent that was changed several years ago.

As Ms. Marchand testified, an operating revenue allowance of 1.5% of O&M Expense provides 5.5 days of operating income. (Marchand Rebuttal, p. 16) Coupled with the probable increases in operating expenses, and the delay in the receipt of increased revenues, an operating revenue allowance of 1.5% will be expended very quickly. Most of the increases to O&M expense accounts for the rate year, which begins on July 1, 2006, are estimated, but unknown. Expenses such as health insurance premiums, workers compensation, State MERS contribution, overtime required by winter weather, police payroll, insurance premiums, rate filing expense, office equipment contracts, annual software maintenance contracts, meter reading equipment, vehicle operating expense, etc, could all be easily more than estimated for the rate year. In fact, during the litigation of this Docket chemicals, power and fuel costs have risen *dramatically*. Furthermore, as set forth in the PWSB's response to Division Data Request 2-32, it received notice of new testing requirements related to the two new EPA proposed Rules, which require additional water quality monitoring. This analysis will be performed by an outside laboratory, and is estimated to be \$30,000 more than originally requested in the rate filing.

As unstable as expenses can be, the greatest unknown facing this utility is not expenses, but the sales of water and the resulting revenues. The PWSB has demonstrated that over the past five years, its water sales have been less than the historic average by more than 6% on average. (C. Woodcock Schedules 2.1, Rebuttal 2.1). In the last two years they were more than 10% below the average. Setting an operating revenue allowance in this case based on 1.5% of the operating costs provides an operating revenue allowance that is less than 0.8% of the total

revenues. In no year has the variation in sales been that low. By only providing a 1.5% allowance on operating expenses, the Commission is not providing a sufficient cushion or allowance for this water utility to generate sufficient revenues to meet its expenses. This problem is compounded by the Division's insistence on using historic averages of sales that fail to recognize the downward trend in water consumption that has been documented in this Docket.

Further exacerbating the problem is the "regulatory lag" inherent in any application for a rate increase. As Mr. Woodcock pointed out in his rebuttal testimony, the decision in this case is due November 10, 2005. Thus, the first bill won't be issued until December (with only a partial amount of the increase billing) and payments won't begin to be made until January 2006.

(Woodcock Rebuttal, p.4) The first *full* bill with all the increase included would not be until February with payments in March. This lag in collections already assures that the revenues allowed will not be collected even if the Division's sales estimates are correct. As an example, with a ten percent increase in revenues, this revenue lag results in collections that are about 0.8% short of the allowed revenues.

Because only half of PWSB's costs are operation and maintenance, providing a 1.5% operating revenue allowance on just operating costs is roughly equal to a 0.8% allowance on total revenues. This full amount can be taken up by just the lag in collections. In effect, the granting of a 1.5% operating revenue allowance on O&M only covers the lag in implementation and provides no funds for unexpected expenses or reductions in sales.

It is the Division's position that the operating income allowance requested by the PWSB should be denied. In fact, Ms. Crane did not believe that the PWSB should have an operating revenue allowance *at all* as it already had an Operating Reserve as required by its bond

indenture. As set forth in her direct, Ms. Crane testified:

“Q. Does the PWSB have another reserve fund available to meet fluctuations in cash flow?

A. Yes, it does. As discussed above, the PWSB also has an Operating Reserve, which is required to be funded at 25% of the PWSB’s annual operating expenses.”
(Crane Direct, p. 32)

“In the event of revenue shortfalls or unanticipated expense increases, the Operating Reserve Fund can be used, although the Operating Reserve would subsequently need to be replenished. By December 31, 2005, the Operating Reserve is projected to have a balance of \$2.2 million...While I believe that an additional Operating Income Allowance is unnecessary, given the Operating Reserve of \$2.2 million that has already been funded by ratepayers I recognize that the Commission recently rejected a similar argument that I made in the Kent County Water Authority base rate case, Docket No. 3660. (Crane Direct, p. 32)

In addition, the PWSB does have the \$2.2 million O&M Reserve available, the purpose of which is to meet shortfalls that may occur from time to time. (Crane Surrebuttal, p. 14)

However, at hearing, Ms. Crane’ altered her position:

“Well, I heard Miss Gurghegian -- and I'm sorry for butchering her name I'm sure --testify today about the operating -- the O&M reserve fund and the fact that in her opinion that fund should not be used to cover operating and maintenance costs on an ongoing basis, and I just kind of want to clarify that that's our position, too. I mean, no where are we recommending that that fund that's required under the bond indenture be used routinely to cover shortfalls or unforeseen increases in expense.” (Tr. v.II, p. 157)

Thus, it would appear that, despite her prior testimony to the contrary, the Division’s expert now acknowledges and agrees with the PWSB that the Operating Reserve required by the bond indenture is no substitute for an adequate operating revenue allowance. Yet, Ms. Crane’s other suggestions for coping with a revenue shortfall are equally impractical. In her various testimonies, Ms. Crane suggests that the PWSB has several alternatives, including delaying IFR or filing for a new rate case. (Tr. v.II, p. 202-203). Neither of these alternatives are in the best interest of the ratepayer.

First, as the Commission knows, the PWSB is in the midst of a capital program designed to eradicate an issue that has plagued it for years – the perceived “dirty” water problem. The PWSB has a new water treatment plant that will be online soon, but it must also continue its aggressive pipeline repair/replacement program. To that end, IFR should not be delayed. Second, the filing of rate cases is a time consuming and inefficient method of dealing with unexpected increased expenses and/or decreased revenues. The regulatory process is lengthy and expensive, and is not designed to meet periodic shortfalls. Furthermore, even though Ms. Crane disregards the negative effect of “regulatory lag,”⁵ it would nevertheless impact the PWSB’s efforts to obtain relief in an emergency situation.

As Mr. Woodcock pointed out in his direct testimony, a municipal utility makes no profit and it does not provide any return or dividend to investors. In effect, it is a break-even proposition - all revenues are spent on the system expenses. A municipal utility can not reduce dividends in a bad sales year or if expenses are higher than expected. The only provision for unknown expenses or a drop in sales that a municipal water utility has is the 1.5% operating revenue allowance that has been allowed by this Commission. Coupling this minimal reserve with overly optimistic sales forecasts dooms a utility to run out of needed cash. As a result, and as testified to in this Docket, a utility must cut back on programs and expenses because of the revenue shortage, and then the Division jumps on those lower historic costs in the next rate filing as evidence that the utility didn’t really need all that funding after all.

Certainly, the PWSB cannot tap into its Operating Reserve fund, and it makes no sense to ask the PWSB to cut back on necessary IFR or to consistently file rate cases for emergency relief

5 (Tr. v.II, p. 13)

to meet shortfalls caused by unexpected increases in expenses or shortfalls in revenue. As was discussed with Commissioner Holbrook and Mr. Woodcock, a portion of the Operating Revenue Allowance could be restricted and the PWSB would be required to make compliance filings to tap into this account. However, continuing the current course of allowing an insufficient Operating Revenue Allowance merely guarantees the PWSB will continue to struggle to meet unexpected expenses and cope with its historic under collection of revenue.

The PWSB has made a clear showing of both the need for an increase in the Operating Revenue Allowance and the basis for its requested amount of 5% on total expenses. The current 1.5% on operating expenses (0.8% on total expenses) barely covers the lag in receipt of new revenues and doesn't even cover the variation in the one year where sales were the closest to average. The PWSB has shown that the historic variation in sales and revenues is closer to 6% of total expenses, but has only requested 5% in this docket. In opposition to this quantified showing by the PWSB, the Division has suggested using funds that aren't available (the O&M Reserve required by the bonds), and when this option was shown to not be available, the Division's suggestion is to slow down needed and approved capital improvements and/or file for rate increases more frequently. This is PWSB's fourth rate filing since 2000. Certainly, this final suggestion cannot be viewed as being practical. The PWSB has provided a carefully thought out and documented rationale for its request such that it is requested that the Commission consider the evidence in this docket and provide PWSB's proposal with the due consideration.

III. CONCLUSION

WHEREFORE, The Pawtucket Water Supply Board prays that The Rhode Island Public

Utilities Commission approve its proposed rate increase in this Docket, and that this Commission approve all other relief it deems meet and just.

PAWTUCKET WATER SUPPLY BOARD
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CERTIFICATION

I, the undersigned, hereby certify that a true copy of the within was mailed on October 31, 2005 by first class mail to the to the service list attached hereto.
